(2)

No. 94-1278

FILED
MAR 3 1995
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

F. SCHUMACHER & CO.,
Petitioner,
v.
ALVORD-POLK, INC., *et al.*,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

Of Counsel:
JAN S. AMUNDSON
General Counsel
QUENTIN RIEGEL
Deputy General Counsel
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Ave., N.W.
Suite 1500—North Tower
Washington, D.C. 20004-1790
(202) 637-3058

DONALD I. BAKER *
Attorney and Counsellor
700 Eleventh Street, N.W.
Suite 615
Washington, D.C. 20001-4507
(202) 637-9499
Attorney for Amicus Curiae

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

1090

QUESTION PRESENTED

The Third Circuit's decision in this case presents a fundamental issue under Section 1 of the Sherman Act concerning the standards for defining an antitrust "conspiracy" when a manufacturer takes action to curb "free riding:"

> Whether evidence from which a jury could infer that a manufacturer's publicly stated reason for a vertical restraint was pretextual is sufficient to permit a jury also to infer that the manufacturer conspired with its complaining dealers to adopt the restraint?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
INTEREST OF THE *AMICUS CURIAE*	1
STATEMENT	2
ARGUMENT	3
I. THE LINE BETWEEN ALLOWABLE "COMPETITIVE COMMUNICATIONS" AND UNLAWFUL "CONSPIRATORIAL CONDUCT" HAS BECOME DANGEROUSLY BLURRED IN THE "FREE RIDER" CONTEXT	3
II. THE CONCEPT OF "CONSPIRACY" SHOULD BE REALISTICALLY TAILORED TO VERTICAL COMMUNICATIONS	5
III. DIRECT SELLING IS AN EVER MORE IMPORTANT PART OF THE MODERN ECONOMY: CLEARER RULES ARE NEEDED WHEN MANUFACTURERS HAVE TO DEAL WITH THE RESULTING "FREE RIDING" ISSUES	9
CONCLUSION	11

TABLE OF AUTHORITIES

CASES — Page

American Tobacco Co. v. United States, 328 U.S. 781 (1946) 9

Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988) 4, 7

Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) 4-6

Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984) 4-6

O.S.C. Corp. v. Apple Computer, Inc., 601 F. Supp. 1274 (C.D. Calif. 1985), *aff'd*, 792 F.2d 1464 (9th Cir. 1986) 10

Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992) 9-10

United States v. Colgate & Co., 250 U.S. 300 (1919) 4

United States v. Realty Multi-List, Inc., 629 F.2d 1351 (5th Cir. 1980) 9

MISCELLANEOUS

E. GELLHORN AND W. KOVACIC, ANTITRUST LAW AND ECONOMICS 323 (4th ed. 1994) 4

Gellhorn, *The Practical Uses of Economic Analysis: Hope versus Reality*, 1991 ABA ANTITRUST SECTION, COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 151 7

A. SMITH, THE WEALTH OF NATIONS 9

VI P. AREEDA, ANTITRUST LAW ¶ 1402.B.4 (1986) .. 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1278

F. SCHUMACHER & CO.,
Petitioner,

v.

ALVORD-POLK, INC., *et al.*,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

This brief is filed on behalf of the National Association of Manufacturers in support of Petitioner F. Schumacher & Co. ("FSC"). Consent from counsel for both parties has been filed with the Clerk of this Court.

INTEREST OF THE *AMICUS CURIAE*

The National Association of Manufacturers of the United States of America ("the NAM") is a non-profit voluntary business association incorporated under the laws

of the State of New York. It is the principal representative of America's manufacturing community. The NAM's membership—approximately 13,000 large and small companies—accounts for about 80 percent of all goods manufactured in the United States.[1] Many of these manufacturers distribute their products to consumers and other end users through independent distributors with restrictions on resale similar to those in this case. As active participants in the free-market distribution system of the United States, NAM members have a vital interest that the federal antitrust laws be interpreted in consistent and predictable ways that enhance business investment and efficiency and consumer welfare.

STATEMENT

This is a classic case of "free riding" by retail dealers who have not invested in consumer education. To protect against this risk, a manufacturer, after receiving complaints from dealers, acts to protect the viability of its distribution system.

Petitioner FSC is a wallpaper manufacturer that requires its distributors to buy books of wallpaper patterns for display to consumers. Respondents are companies that (i) take wallpaper orders over "800" telephone numbers from consumers who have identified their desired wallpapers by visits to traditional dealers' showrooms, and then (ii) arrange for direct shipment from the manufacturer to the customer. Petitioner, whose business was substantially and directly injured by this practice because its traditional dealers were reducing their investments in pattern books and showroom facilities, took steps to eliminate it: *first*, in 1988, it instituted a surcharge on drop shipment charges (*i.e.*, shipments direct from the manufacturer to the customer); and *second*, in 1990, it adopted

[1] The NAM is affiliated with an additional 158,000 businesses through the Associations Council and the National Industrial Council.

a "local area trading policy" that prohibited a retailer from selling to customers outside its local trading area. These actions had the desired effect of restoring Petitioner's sales to its dealers by eliminating free-riding sales of "800" retailers.

Plaintiffs sued, alleging Sherman Act conspiracies between FSC and other manufacturers, and between FSC and traditional dealers. Summary judgment for FSC was granted on the alleged manufacturers' conspiracy because "plaintiffs' evidence shows only an opportunity to conspire, not an agreement to do so." (Pet. App. A34). However, on the alleged conspiracy with dealers, the Court below reversed its position on rehearing and rejected the trial court's summary judgment for the Petitioner because "inconsistencies in and contrasts between the internal and public explanations of the drop shipment policy" might be seen by a jury "as implying a sinister motive." (Pet. App. A33).

ARGUMENT

I. THE LINE BETWEEN ALLOWABLE "COMPETITIVE COMMUNICATIONS" AND UNLAWFUL "CONSPIRATORIAL CONDUCT" HAS BECOME DANGEROUSLY BLURRED IN THE "FREE RIDER" CONTEXT

This case offers the Court a striking opportunity to clarify the line between unlawful "conspiracy" and protected communications fostering interbrand "competition" under Section 1 of the Sherman Act. Because a manufacturer (such as Petitioner FSC) necessarily must communicate with its distributors and dealers if it is to compete effectively with other manufacturers, it is constantly exposed to antitrust risk—and the threats of penal treble damages—if the line between "competitive communication" and "conspiracy" is allowed to become dangerously blurred. Allowing a case to go to the jury on a "conspiracy" theory where only "competitive" communications occur will chill such communications and blunt the efficiency

of competitiveness of both the manufacturer and its distributors.

The Court has addressed the line between "conspiracy" with dealers and "unilateral action" (by the manufacturer) many times. The cases most relevant here are: *United States v. Colgate & Co.*, 250 U.S. 300 (1919) and *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984) (where this Court "revitalized *Colgate*." E. GELLHORN AND W. KOVACIC, ANTITRUST LAW AND ECONOMICS 323 (4th ed. 1994)).

This Court has also examined the "free rider" problem and recognized that its control by manufacturers and dealers is critical to effective retailing, especially where some (but not all) dealers perform educational, warranty and sales-enhancing services on behalf of the manufacturer. Recognizing that "each retailer's benefit would be greater if all provided the services than if none did," this Court upheld vertical restraints similar to those adopted by the Petitioner here in overturning the ten-year old *per se* rule on territorial allocations in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977). The Court also showed a similar sensitivity to the "free rider" problem in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 726 (1988), when it narrowed the *per se* vertical price fixing rule to an agreement "on the price or price levels to be charged by the remaining dealer."

The present case is potentially illuminating because the Third Circuit's failure to dismiss the "conspiracy" claims arises in a context where the manufacturer has a strongly-presumed unilateral interest created by the undisputed "free rider" effects. Where a manufacturer's interest in unilateral action to minimize the effects of a free rider is so clear, it is an especially good opportunity for this Court to set the bounds of triable issues.

II. THE CONCEPT OF "CONSPIRACY" SHOULD BE REALISTICALLY TAILORED TO VERTICAL COMMUNICATIONS

The Court's closest recent attention to the vertical "conspiracy" issue was in *Monsanto*, 465 U.S. 752, 758-59 (1984), where it overturned the Seventh Circuit's holding that "proof of termination following competitor complaints is sufficient to support an inference of concerted action." 684 F.2d 1226, 1238 (7th Cir. 1982). The Court held that "[i]f an inference of such an agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded." 465 U.S. at 763.

That precise risk was ignored by the Court of Appeals below. Its "conspiracy" rule fails to recognize the legitimate needs of a manufacturer and its distributors constantly to communicate with one another about marketing. Such discussions inevitably will (and must) include nonperformance by a competing distributor to the detriment of the overall program. A manufacturer is properly concerned that any marketing programs it adopts be properly supported by dealers who implement them, and that "free riders" not be allowed to torpedo a distribution program. *Monsanto*, 465 U.S. at 762-63. This is true whether the product is simple or complex, potentially harmful or obviously beneficial, old or new, or generally unknown. Dealers who fail to carry out education and promotion activities or provide follow-on services have inherent cost advantages over those that do perform. Thus, they have strong incentives to become "free riders" by making sales to customers who have already been educated and convinced about the product by the full-service dealer. *See Continental T.V.*, 433 U.S. at 55. Without some protection by the manufacturer, promotional, educational and other "services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did." *Id.*

Because the "free rider" problem is critical—indeed often determinative of the survival of both manufacturers and distributors—special care must be taken in framing any rule which infers "conspiracy" from "competitive communications" with its dealers or the public. Very often, as here, the manufacturer's interest is precisely the same as the burden-bearing distributor: the manufacturer wants its products distributed in the most effective way to the largest number of potential customers willing to pay the true costs of the product, and it wants customers to be informed so that they are more likely to be satisfied with the product afterwards. Thus, to infer a "conspiracy" merely from complaints or discussions about "free riding" is to commit a serious error. In such circumstances, standing alone, there is (as the Court stressed in *Monsanto*) no "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently." 465 U.S. at 764.

The appropriate rule should recognize the manufacturer's unilateral interest in acting to resolve "free rider" problems. In this case, the manufacturer's "local trading area policy" (with its echoes of the location policy upheld in *Continental T.V.*) works commercially because the full-service retailers have an incentive to invest in display books and showrooms to presell their product. Thus, the manufacturer's policy is best seen as a unilaterally created inducement for effective marketing of the product by its dealers. There is every reason to assume, *absent contrary evidence*, that "the manufacturer and nonterminated distributors were acting independently." *Id.*

There is strong reason why the presumption of legitimacy should not be lightly pushed aside, as the Third Circuit has done, but as some others have not.[2] To expose the manufacturer to a vaguely-framed conspiracy claim in relation to a "free rider" problem is hazardous to

---

[2] *See* conflicting cases cited in FSC's Petition for Writ of Certiorari at 10.

the manufacturer—for reasons spotlighted by the Court in *Business Electronics*:

> In the vast majority of cases, it will be extremely difficult for the manufacturer to *convince a jury* that its motivation [in restraining the "free rider"] was to ensure adequate services, since price cutting and some measure of service cutting usually go hand in hand. Accordingly, a manufacturer . . . exposes itself to the highly plausible claim that its real motivation was to terminate a price cutter. . . .

485 U.S. at 727-28 (emphasis added). Accordingly, the Court warned:

> Manufacturers would be likely to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties.

Id. at 728.

In other words, a foreclosed or terminated "free rider" should not be entitled to get to a jury on a "conspiracy" theory simply because the manufacturer (1) communicated with other distributors over the problem, and (2) publicly explained its policy for dealing with the "free riding" problem in words that differed from a preliminary draft.[3] Rather, the proper focus of the judge's inquiry concerns the state of interbrand competition, the manufacturer's sales and service program, and the legitimacy of the manufacturer's concern about weakening of the performance of sales and display obligations by the traditional "full service" distributors. If, as in the present case,

---

[3] It may well be that errors in explanation will arise—especially in the vertical context—because "the businessmen who have followed a particular path or adopted a restraint [cannot] explain the reasons for this approach. . . . In point of fact, they frequently develop methods of doing business through educated trial and error. . . . [The business manager's] objective is to maximize profits, not to justify his actions for antitrust enforcers or courts." Gellhorn, *The Practical Uses of Economic Analysis: Hope versus Reality*, 1991 ABA ANTITRUST SECTION, COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 151, 152.

each can be answered so as to ensure that the manufacturer is responding to a legitimate "free rider" problem, then a Section 1 case with only circumstantial evidence—even if it includes a pretextual explanation—should be insufficient to overcome the *Monsanto* requirement.

The fact that FSC's public explanation of its drop shipment charge was different from its draft explanation should not raise a triable issue of conspiracy in a "free rider" context when it has a clear unilateral interest.[4] There is no evidence of cover-up, crime or fraud—but simply a choice of how to portray a business action to the public. The Respondents were apparently not misled by the statements. To convert the Petitioner's business choice on how to explain a decision into the basis on which such a manufacturer can be thrust in front of a jury on a "conspiracy" theory is a serious retreat from the Court's practical message of *Monsanto* and *Business Electronics* in circumstances where the manufacturer has obvious incentives for independent action. The situation cries out for a clear and predictable rule.

In this situation, the Court needs to curb the use of "conspiracy" concepts developed in the horizontal competitor context when dealing with "free riding" in the manufacturer-dealer context. Random discussions among

---

[4] The apparently deleted language is itself entirely consistent with a unilateral decision by FSC to deal with a "free rider" problem:

> "In direct response to retailer requests, we at F. Schumacher & Company are proud to announce that we will assertively support our dealers in their local trading areas and protect them from sales piracy by adding a seven percent surcharge onto all drop shipments . . . While bar coding is a breakthrough for the industry in terms of product identification we feel that it alone is not an entirely effective deterrent against sales piracy . . . . Our approach attacks the problem at its root and makes the accounts who drop ship feel the effects, rather than leaving the responsibility of policing to the retailers."

(Quoted at Pet. App. A32).

unintegrated direct competitors have long been treated as suspect, for reasons that Adam Smith famously articulated. *See* A. SMITH, THE WEALTH OF NATIONS, quoted in *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1370 (5th Cir. 1980). Therefore, if there is some cover-up of inherently suspicious horizontal communications (*e.g.*, by falsifying travel or telephone records), then the courts might accept this as supporting an inference of "conspiracy" that might be sent to the jury to determine whether the alleged conspirators "had a unity of purpose or a common design and understanding, or a meeting of minds." *American Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946). The same policy simply does not apply in the vertical context where communications are necessary and regular, and do not become "conspiracies" because prices or price-related issues are involved. *See Colgate* and *Monsanto*. Accordingly, Professor Areeda warns that "great care is required before extending the conspiracy concept beyond horizontal cases and the usual vertical cases involving restricted distribution, tying and exclusive dealing. In particular, discussions, suggestions, recommendations, and the giving of information do not indicate any conspiracy where the action imposing the alleged restraint does not wish or need acquiescence of the other party or any *quid pro quo* from him." VI P. AREEDA, ANTITRUST LAW ¶ 1402.B.4 (1986).

III. DIRECT SELLING IS AN EVER MORE IMPORTANT PART OF THE MODERN ECONOMY: CLEARER RULES ARE NEEDED WHEN MANUFACTURERS HAVE TO DEAL WITH THE RESULTING "FREE RIDING" ISSUES

Increasingly, in a world of two-employee couples and single working parents, traditional merchandise is being sold by distant sellers with "800" telephone numbers. *See Quill Corp. v. North Dakota*, 112 S.Ct. 1904, 1908 (1992) (noting "the remarkable growth of the mail-order

business 'from a relatively inconsequential market niche in 1967,' to a 'goliath' with annual sales that reached 'the staggering figure of $183.3 billion in 1989,' " quoting 470 N.W.2d 203, 213 (N.D. 1991)).

This new phenomenon is often very unpopular with traditional retailers and has generated a wide variety of legal conflicts under older, established legal doctrines (*see, e.g., Quill Corp.*, involving state sales and use taxes). The situation is potentially hazardous for a manufacturer selling to both types of retailers. The risk is particularly clear that the mail-order retailer will accuse the manufacturer of conspiracy with traditional retailers, even in a case where the product requires substantial pre-sale education and post-sale service. *See, e.g., O.S.C. Corp. v. Apple Computer, Inc.*, 601 F. Supp. 1274 (C.D. Calif. 1985), *aff'd*, 792 F.2d 1464 (9th Cir. 1986) (manufacturer prohibition on mail order sales of its computers).

The present case does not involve the classic catalog seller (such as Lands End) that creates its own brands and offers them through its own catalogs. The Respondents neither (i) create their own products, nor (ii) provide their own education and sales material. Rather, they seek to survive directly off the efforts of others—the manufacturer who develops and sells the catalog books, and the retailer who buys and displays them. The Respondents are thus indisputable "free riders" as the Third Circuit found.

The Court has an opportunity to deal squarely with basic Sherman Act conspiracy rules in a "free rider" context—thus providing the type of guidance that it provided for the "complaint and termination" question in *Monsanto* and the vertical *per se* pricing rule in *Business Electronics*. The Court can give manufacturers greater clarity and predictability in dealing with a growing set of issues, by injecting a strong presumption of legitimacy into manufacturer-dealer communications on "free rider" issues.

CONCLUSION

Accordingly, the NAM urges that a writ of certiorari be granted in this case.

Respectfully submitted,

Of Counsel:
JAN S. AMUNDSON
General Counsel
QUENTIN RIEGEL
Deputy General Counsel
NATIONAL ASSOCIATION
OF MANUFACTURERS
1331 Pennsylvania Ave., N.W.
Suite 1500—North Tower
Washington, D.C. 20004-1790
(202) 637-3058

DONALD I. BAKER *
Attorney and Counsellor
700 Eleventh Street, N.W.
Suite 615
Washington, D.C. 20001-4507
(202) 637-9499
Attorney for Amicus Curiae

* Counsel of Record

March 3, 1995